D. Industry Profitability

The next data examined are those relating to industry profitability. Figure 21 shows the operating cash flows for broadcast networks and their affiliates over the 1989-1997 period. As can be seen from the figure, the affiliates consistently have much higher operating cash flows than do the networks. This pattern is consistent with network reports that their owned and operated stations—rather than the network operations themselves—are the source of the majority of their profits.[42]

Because there has been so much confusion about the significance of profitability data for the formulation of public policy, it is worth taking some time to examine the economic relevance of these data. The public policy issue is not a question of which company makes how much money. And the issue is not whether the networks will be driven out of business; they won't. The issue is the quality of the programming the networks will offer. The importance of profitability for public policy is whether broadcast networks and stations will be able to organize efficiently and thus have the appropriate incentives to continue offering high-quality programming on non-subscription broadcast television.

Claims that the networks are making "lots of money" miss the point. Whether the networks' profits are high or low, and whether these profits come from the owned and operated stations or the network operations themselves, inefficient rules distort competition and investment. These effects arise when regulations limit a network and station's ability to structure their business relationship in ways that give both parties

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42 In fact, some industry analysts are quite pessimistic about broadcast network profitability, particularly in comparison with cable network profitability. See, for example, Diane Mermigas, "As tide turns, cable sails past Big 4," *Electronic Media*, August 16, 1999 at 13.

FIGURE 21
BROADCAST NETWORKS AND STATIONS OPERATING CASH FLOW
1989-1997

	Broadcast Networks ($ millions)								
	1989	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
ABC [1]			155	130	228	578	362	334	140
CBS [1]			-32	71	209	218	42	65	-31
NBC [1]			-23	80	100	179	291	446	512
Fox [1]			59	85	116	-196	114	115	76
Big Three			100	281	537	975	695	845	621
Big Four [2]	772	680	159	366	653	779	809	960	697

	Broadcast Stations ($ millions)								
	1989	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Big Three Affiliates [3]	3,887	3,772	3,107	3,627	3,892				
Big Four Affiliates [3]						6,258	6,207	7,514	7,452

Sources:

[1] Paul Kagan Associates, *The Economics of TV Programming & Syndication*, 1999 (p. 160 and 163), 1998 (p. 129), and 1994 (p. 18).

[2] For 1989-90, Paul Kagan Associates, *TV Program Investor*, June 17, 1998

For 1991-97, Paul Kagan Associates, *The Economics of TV Programming & Syndication*, 1999 (p. 160 and 163), 1998 (p. 129), and 1994 (p. 18)

[3] *NAB Television Financial Reports*, 1992 and 1993; and *NAB/BCFM Television Financial Reports*, 1990, 1994-1998

Warren Publishing, Inc., *Television & Cable Factbook*, Services Volume, 1993-1998 Editions, "Television Networks."

Declaration of Stanley M. Besen on Behalf of Plaintiffs Turner Broadcasting System, Inc., et al., May 24, 1995, Exhibit D-2 (ultimate source: Warren Publishing, Inc., Washington, D.C.).

Warren Publishing, Inc., *Television & Cable Factbook*, Services Volume, 1994-1998 Editions, "Affiliations by Market."

incentives to invest in strengthening their programming and promotional activities. Regulations that impose inefficient relationships on networks and the stations that distribute their programming reduce the profitability of investing in high-quality programming. Consequently, such rules degrade the quality of programming offered over-the-air on a non-subscription basis.

Another pattern that has been observed repeatedly is that affiliated stations are more profitable than are independent stations.[43] Again, this is an area in which there has been considerable misinterpretation of the meaning of the data. Some industry observers have incorrectly concluded that this pattern of profitability implies that affiliates are dependent upon the networks and lack bargaining power. In fact, this pattern supports the opposite conclusion. First, the existence of independent stations demonstrates that stations can survive without network affiliation. More important, the fact that affiliates are more profitable than independent stations demonstrates that affiliates have been able to reach profitable agreements with the networks. The affiliated stations have bargaining power that allows them to capture a significant portion of the profits from their operations as parts of networks.[44]

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43 See, for example, Beutel, Kitt, and McLaughlin, Broadcast Television Networks and Affiliates—1980 and Today, National Economic Research Associates (October 27, 1995) attachment to Comments of the Network Affiliated Stations Alliance, *In Re 1998 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, MM Docket 98-35 (July 21, 1998), Section III.D.

44 This bargaining power may stem from the fact that some stations are better run and stronger than are others. Such stations would have better prospects as independents and also would be more desirable as affiliates than would weaker stations. Alternatively, the bargain between a network and an affiliate may reflect the fact that it is in *both* parties' interests that each sees benefit from the relationship and thus has incentives to contribute to their collective well being.

E. Alternative Outlets

In designing and applying regulation to the networks it is important to recognize who and what the broadcast television networks are. One way to view them is as program distributors, some of whom also happen to be large group owners. But a more useful perspective views the networks as producers of high-quality programming who seek efficient distribution for that programming. The parents of ABC, CBS, Fox, NBC, UPN and The WB all have production arms for dramas and comedies. ABC, CBS, Fox, NBC, and Time Warner all have large national and international news operations. And ABC, CBS, Fox, and NBC have major sports programming operations.

While over-the-air broadcasting is one way the networks' parent companies distribute content, there are others, both existing and potential. Figure 22 presents a partial listing of cable properties in which the four largest broadcast television networks have ownership interests. As shown in the figure, the four largest networks and/or their parent companies all have made significant investments in cable properties. These investments make good economic sense from both private and social perspectives. Networks have valuable programming assets, brand names, and production and promotion skills. It is profitable and efficient to make use of these skills and assets in a variety of ways.

A similar picture emerges with respect to Internet properties. Figure 23 provides a partial listing of Internet properties in which the networks and/or their parent companies

FIGURE 22
BROADCAST NETWORK OWNERSHIP CABLE PROGRAM SERVICES
1999

Broadcast Network [1]	Cable Program Service
ABC	
	A&E
	Classic Sports
	Disney
	E!
	ESPN
	ESPN2
	ESPNews
	History
	Lifetime
	Toon Disney
CBS	
	Country Music
	Nashville Network
Fox	
	Fox Family Channel
	Fox News
	Fox Sports Americas
	Fox Sportsnet
	FX
	FxM
	The Health Network
	National Geographic
	Outdoor Life
	Speedvision
	TV Guide Channel
NBC	
	A&E
	AMC
	Bravo
	CNBC
	Court TV
	History
	MSNBC

Note:
[1] Ownership is attributed to a network regardless of whether the network, its parent company, or a related company holds the interest.

Sources:
ABC, CBS, and Fox.
Paul Kagan Associates, *The Economics of Basic Cable Networks 1998*, pp. 54-56.

FIGURE 23
BROADCAST NETWORK OWNERSHIP OF INTERNET SITES AND OTHER WEB HOLDINGS
1999

Broadcast Network [1]	Internet Sites and Other Web Holdings
ABC	
	ABC.com
	ABCNews.com
	Disney Blast
	Disney.com
	ESPN.com
	GO Network
CBS	
	CBS MarketWatch
	CBS SportsLine
	CBS.com
	hollywood.com
	Jobs.com
	Medscape.com
	Office.com
	Rx.com
	StoreRunner.com
	Switchboard.com
	Wrenchead.com
Fox	
	Fox.com
	Foxinteractive.com
	FoxMarketWire.com
	FoxNews.com
	FoxSports.com
	NYPost.com
	TVGuide.com
NBC	
	CNBC.com
	Interactive Neighborhood
	MSNBC.com
	NBC.com
	Snap.com
	VideoSeeker
	Xoom.com
UPN	
	UPN.com
	sites for UPN Shows
	(including *Moesha*, *Clueless*, *Dilbert*, *Star Trek: Voyager*, and *Love Boat*)
WB	
	WarnerBros.com
	sites for WB Network Shows
	(including *Dawson's Creek*, *7th Heaven*, and *Buffy the Vampire Slayer*)

Note:
[1] Ownership is attributed to a network regardless of whether the network, its parent company, or a related company holds the interest.

Sources:
ABC, CBS, and Fox.
Richard Tedesco, "NBC to Spawn Net Unit," *Broadcasting & Cable*, May 17, 1999, p. 49.

are investing.[45] Again, the investments make commercial sense and are not themselves a source of public interest concern.

While it is efficient for the networks to make use of their valuable assets and skills by branching into cable and the Internet content, this trend does have an important implication for regulation: if regulation distorts economic returns in broadcasting, networks will be inefficiently driven to direct more of their financial and creative resources toward cable properties and other distribution platforms. Networks will make some of these investments in any event, but their business decisions should not be skewed and distorted by outdated government regulations.

It is critical to recognize that the fact that the networks are branching into other services is *not* the problem—it is privately and socially valuable for them to make use of their skills and assets in these other services. Rather a problem arises when regulation distorts the networks' investment decisions. Indeed, regulations that make it artificially difficult to branch out into other media also generate social costs. As a 1991 FCC staff report concluded:

> Broadcasters should not be hindered excessively from diversifying to make efficient use of their core skills—production, acquisition, and scheduling of programming, as well as selling advertising. The physical distribution of the broadcast signal is, in fact, a small part of the broadcasters' business.[46]

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45 See also Eric Quinones, "Media Companies Adding Web Cachet – Powerhouses Hold Some New Cards," *The New York Times*, August 1, 1999 at BU 7.

46 Florence Setzer and Jonathan Levy, *Broadcast Television in a Multichannel Marketplace*, Federal Communications Commission Office of Plans and Policy Working Paper No. 26 (June 1991) at x.

F. Why These Industry Trends Matter for Public Policy

The data analyzed in this section of the white paper clearly demonstrate that the broadcast television industry has changed dramatically over the past fifty years. The regulatory regime governing broadcast television has not undergone a similarly sweeping transformation. Of course, it does not automatically follow that regulation is out of date or no longer serves the public interest. Perhaps we have been blessed with policies sufficiently flexible that they promote the public interest even in the face of tremendous economic change. Unfortunately, the evidence clearly demonstrates that we have not.

The remainder of this white paper examines the national multiple ownership rule to see what role it plays in today's economic environment. Empirical and logical analyses demonstrate that the rule has not kept up with the times. Whatever value this rule may have had in the past, today it give rise to efficiency costs with no offsetting benefits.

IV. THE NATIONAL TELEVISION MULTIPLE OWNERSHIP RULE

A. Background

The national multiple ownership cap provides an instructive example of a regulation that no longer serves the public interest in the new economic environment. Under the current rule, a single entity cannot control stations whose combined reach exceeds 35 percent of U.S. television households.[47] There is no limit on the number of stations that a single group owner may control, however. Moreover, when a group owner

[47] 47 CFR Section 73.3555(e).

holds two licenses within a single Designated Market Area (DMA), that audience is counted only once for purposes of the national reach cap.[48]

The national multiple ownership cap is an outgrowth of radio policies adopted in the 1940s. Figure 24 presents a brief timeline.[49] Several points about the timeline are notable. First, the national cap was first implemented in a completely different economic environment. While the form and level of the national ownership cap has changed over time, its essential structure has remained unchanged. Second, it has evolved much more slowly than called for by those who have analyzed it. Indeed, under a Commission order issued in 1984, the cap was to have been eliminated by 1990.[50] However, in the face of considerable Congressional opposition to the relaxation of the cap, the Commission quickly reversed itself on reconsideration.[51] As the analysis below will demonstrate, the Commission and its staff reached the correct conclusion in 1984.

B. The Rule is Costly in Today's Environment

The failure to relax the cap has adverse consequences for efficiency, competition, and consumers. There are at least three types of costs to which the current rule gives rise.

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48 See *In the Matter of Broadcast Television National Ownership Rules, Review of the Commission's Regulations Governing Television Broadcasting, and Television Satellite Stations Review of Policy and Rules,* Report and Order, released August 6, 1999, ¶ 1.

49 For a more detailed history, see *In the Matter of Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations,* Report and Order, released August 3, 1984, ¶¶ 11-18, and references therein.

50 *In the Matter of Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations,* Report and Order, Docket No. 83-1009, released August 3, 1984.

51 *In the Matter of Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations,* Memorandum Opinion and Order, Gen. Docket No. 83-1009, released February 1, 1985.

FIGURE 24
NATIONAL OWNERSHIP CAP TIMELINE

1940-1953: Numerical cap rises from 3 to 5 to 7 stations (in last case, no more than 5 allowed to be VHF stations).

1984: FCC concludes that cap does not protect diversity and may hinder localism and competition. Cap scheduled to sunset by 1990.

1984: In the face of Congressional opposition, FCC eliminates sunset provision. Cap set at 12 stations with a 25 percent reach.

1992: FCC Notice of Proposed Rulemaking seeks comment on proposals to relax the national multiple ownership limits, in part because resulting efficiencies "could permit the production of new and diverse, including locally produced, programming."[1]

1995: FCC Notice of Proposed Rulemaking states that relaxing the cap threatens neither competition nor diversity.[2]

1996: Telecommunications Act of 1996 removes numerical limit and raises reach cap to 35 percent.

1999: FCC determines that the audiences of two commonly owned stations in a single market count only once in applying the national reach limit.

1 *In the Matter of Review of the Commission's Regulations Governing Television Broadcasting,* MM Docket No. 91-221, released June 12, 1992, ¶ 11, footnote omitted.

2 *In the Matter of Broadcast Television National Ownership Rules, Review of the Commission's Regulations Governing Television Broadcasting, and Television Satellite Stations Review of Policy and Rules,* Further Notice of Proposed Rule Making, MM Docket No.s 91-221 and 87-8, released January 17, 1995, ¶¶ 98 and 99.

First, the cap limits the realization of economic efficiencies. There are economies of scale and scope associated with operating multiple stations jointly. For example, according to Fox, its owned and operated stations can share news equipment (*e.g.*, satellite news gathering trucks), staff, and market research strategies to reduce the average costs of producing regional news stories.[52] This is one of the reasons that most stations are run by group owners. By placing a ceiling on the size of group owners, the national ownership cap places a ceiling on the realization of economies of scale and scope.[53]

Second, the cap blocks expansion of particularly well-run station groups. Even if there were no economies of scale or scope, some station groups would be better run than others. Whether due to luck, greater investment, or superior hiring and training policies, some station groups can manage stations at lower cost and provide more desirable programming than can others. In the absence of regulatory restraints, station groups with superior skills would expand. Clearly, this would benefit those station groups. More important, it would also benefit viewers and advertisers—viewers because they would receive more desirable programming, and advertisers because they would have access to larger audiences. The national ownership cap thus harms the public interest by limiting the ability of efficient station groups to expand.

Third, and perhaps most important today, the national ownership cap limits the ability of networks and the stations that broadcast their programming to coordinate their

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52 Joint Comments of Fox Television Stations, Inc. and USA Broadcasting, Inc. *In the Matter of 1998 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, MM Docket 98-35 (July 21, 1998) at 17.

programming and promotional activities and to align their economic incentives. The reason for this distortion is that the national cap limits network ownership of stations, and ownership is the institutional arrangement that most fully aligns the economic incentives of a network and a station broadcasting its programming. The increased profits derived from owned and operated stations are an important factor in determining a networks' willingness and ability to bid for costly event programming such as the broadcast rights to National Football League games, the Olympics, and theatrical movies. Station ownership also affects the networks' incentives to invest in programming developed solely for television, such as comedies and dramas. By limiting the extent to which networks can own stations, the national multiple ownership rule thus reduces television networks' incentives and abilities to promote and compete for high-quality, high-cost programming dedicated to their non-subscription broadcast services.

Because of their importance, it is worth examining in greater detail the coordination benefits associated with network ownership of stations and the mechanism by which programming investment incentives are thus strengthened. Consider the incentives of a network that is choosing whether to invest in costly new programming. Moreover, consider the hypothetical situation in which the network owns none of the stations that broadcast its programming. Investing in higher quality programming will attract a larger audience and, all else equal, will allow the network to earn greater revenues from the sale of network advertising. The affiliates will benefit as well—in their case from the sale of their inventory of advertisements run during network programming. This benefit to the affiliates is not, however, a direct incentive for the

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[53] This raises the question of why not every group owner is at the cap. It may be that some companies do not want to take that large a position in the broadcasting industry or for some other

network. As long as the terms of the affiliation contracts are fixed, the network derives no incremental benefits from the affiliates' increased profits. Hence, the network tends to invest too little in programming (or promotion) relative to the collective interests of the network and its stations as a system. This result is a consequence of the fact that the network bears all of the costs of investing in higher quality programming, but receives only a fraction of the benefits.

To see this point most vividly, consider for argument's sake the opposite hypothetical. That is, suppose the network owned all of its stations. In that case, the network would internalize all of the costs and benefits of higher quality programming, and it would have incentives to maximize the overall financial performance of the network and the stations by making additional programming investments.

One might argue that if coordination were so important, then networks and their affiliates would find a way to coordinate with one another without common ownership. In fact, to some extent they have. For example, at various times ABC, CBS, and Fox have reached specific agreements with their affiliates to help finance the acquisition of broadcast rights to National Football League games. However, the ability to rely on arm's length coordination as a solution to this problem is limited by at least four factors.

First, it is a cumbersome and ad hoc process that can take weeks or even months to work through.[54] A network going through such a process may not be able to move quickly enough to compete for programs that are put up for bid. Moreover, given the costs (in terms of management time and effort) and complexity of the process, it would

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reason lack access to capital and managerial assets needed to attain that scale.

[54] For example, Fox began discussions with its affiliates regarding their making contributions toward NFL broadcast rights in February 1998 and did not reach agreement until August 1998.

be impractical to use it frequently (*e.g.*, every time the broadcast rights for a major theatrical film came up for sale).

Second, even when the process of negotiating with affiliates is used, the coordination is unlikely to work as well as ownership—the internalization of financial returns through arm's-length deals always is incomplete.

A third problem is that any one station may ignore the effects that its actions have on other affiliates, as well as the network. A single station may reason that its refusal to pay for broadcast rights will not affect the overall network decision to acquire those rights. In this way, that station may be able to obtain the benefits of the broadcast rights without fully sharing in their costs. But if each station reasons that way, no one will support the program acquisition.

A fourth problem is that public policy limits the sorts of agreements that networks and affiliates can reach with one another.[55] Without full freedom to write contracts with one another, networks and affiliates are limited in their ability to harmonize their economic incentives in order to promote their common interests in providing competitive programming. Thus, regulation is an obstacle to network-affiliate coordination.

The national multiple ownership cap imposes efficiency losses on the economy by limiting the efficient expansion of group owners. Today, only two station groups—those of CBS and Fox—are near the national ownership cap.[56] One might incorrectly conclude that the small number of group owners near the national ownership cap implies that the cap has little effect. However, discussions with network executives suggest that some

55 Examples include the Right to Reject Rule and the Network Advertising Representation Rule.

56 The fact that both are network station groups is not surprising given that network groups benefit from coordination economies in ways other groups do not.

networks may be reluctant to make additional investments in stations until they know what the rules will be. Moreover, the current relaxation of the rule was put into effect in 1996, so the industry may not yet be in equilibrium. Further, even if only CBS and Fox wish to expand, the fact that they cannot do so harms viewers, advertisers, stations, and those networks.

Some supporters of the national cap argue that reform is unneeded because the networks earn sufficient profits from their current station groups to remain in business. This argument by the cap's supporters completely misses the mark. According to the networks, they do indeed continue to operate because they recoup some of their programming investments through their owned and operated stations. But the policy concern is not that the networks are about to go out of business. Rather, the concern is that the national multiple ownership rule inefficiently distorts network investments, to the detriment of networks and viewers alike.[57] The fact that the networks find their owned and operated stations to be profitable—and that these profits provide incentives to invest in programming and promotion—is exactly why relaxing the national multiple ownership cap is in the public interest. Increased network ownership of stations will lead to increased incentives to invest in and promote the programming that will best satisfy viewer desires and thus attract the largest audiences.

The fact that networks want to purchase additional stations is itself an indicator that they believe they can run the stations more efficiently and earn greater profits than can their current owners. If not, the networks would not be willing to pay the current owners enough to induce them to sell their stations. The gains a network expects from station ownership must come from lower costs or increased audiences (which translate into greater advertising revenues).[58] When the gains are from lower costs, viewers and advertisers benefit through competition to serve them. And when the gains are from increased ratings, those increases reflect the fact that the new owner is doing a better job of satisfying viewer wants than was the old.

C. The Rule Does Not Promote Public Interest Goals

In theory, the national multiple ownership rule might create public interest benefits that outweigh the costs identified above. Proponents of the national cap argue that it protects the public interest in several different dimensions, including: (a) competition; (b) diversity; (c) minority ownership; and (d) localism.[59] However, an examination of the facts reveals that there is no evidence that the national ownership cap promotes any of these public interest goals.

The Rule Does Not Promote Competition. Proponents of the national cap sometimes argue that it protects competition by preventing undue concentration of station ownership. Such assertions do not fit with the facts. The fundamental fact is that competition for viewers takes place at the local level. Only those stations in a viewer's local market can compete for his or her patronage. Thus, increased national ownership

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57 This is one reason why arguments about the networks' accounting statements for their station groups are red herrings. There is no point in worrying about accounting—everyone appears to agree that there are aggregate profits and that stations get more of them than do the networks.

58 Logically, there could be an exception if a network expected buying one station to increase its bargaining power with other stations. There is, however, no evidence that any such effect arises. Moreover, it is implausible that the ownership of additional local stations would give networks additional bargaining power vis a vis affiliates in other cities given that the relevant markets are local.

59 It is notable that promoting minority ownership and localism were not stated as rationales for the adoption of the national multiple ownership cap. See *In the Matter of Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to*

does not reduce competition for viewers. For the same reason, increased national ownership does not reduce competition for either national or local advertising. Although ads are sold on a national basis, *local* concentration is what is relevant for an analysis of advertising competition because viewer exposures to advertisements occurs at a local level. Increased national ownership does nothing to reduce competition for advertisers.

Policy makers have long recognized that the national cap does nothing to promote or protect competition. For example, the U.S. Department of Justice filed comments in a 1983 Commission proceeding in which the Department stated that eliminating the national multiple ownership limits would "raise little risk of adverse competitive effects in any market."[60] And the Commission itself reached a similar conclusion in its 1984 Report and Order.[61]

Indeed, relaxing the national ownership cap might actually increase competition in several dimensions. The greater coordination efficiencies that increased network ownership would bring about would increase the networks' incentives to improve their program offerings, thus strengthening competition for viewers and ultimately advertisers. In the same way, this increased coordination would also intensify competition in the markets for programming and creative talent.

Multiple Ownership of AM, FM, and Television Broadcast Stations, Report and Order, released August 3, 1984, ¶ 17.

60 Quoted in *In the Matter of Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations*, Report and Order, released August 3, 1984, ¶ 65.

61 *In the Matter of Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations*, Report and Order, released August 3, 1984, ¶ 108.

Some might worry that elimination of the national ownership cap would lead to wholesale changes in industry structure that would give rise to unforeseen consequences. Such concerns are misplaced for at least two reasons. First, as just discussed, competition issues generally concern local ownership, not national. Thus, the national ownership cap and national ownership concentration generally are irrelevant. Second, most stations today are owned by groups who fall significantly below the national cap.[62] Thus, the national cap is not the primary factor limiting overall ownership concentration. While relaxing the cap would likely lead to the expansion of some group owners, particularly the network station groups, the overall effects on industry structure are unlikely to be sweeping. Most groups could increase their reaches today if they wished to do so, yet they have not made that choice.

Before concluding this discussion of competition, it is useful to examine one other argument that has been put forth by some proponents of maintaining national multiple ownership limits. These proponents assert that the cap is needed to protect the perceived economic interests of the affiliates. Such an argument would have to be built on three faulty premises: (1) the networks have "too much" economic power when bargaining with affiliates; (2) relaxing the national ownership rule would significantly increase network bargaining power; and (3) as a result of the exercise of this power, viewers' needs would not be met. As discussed below, all three of these premises are invalid.

In analyzing the balance of economic power between the networks and their affiliates, two central findings of the economic analysis of bargaining are pertinent. The first is that the relative bargaining strengths of the different parties depend in part on what

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[62] See Figure 19.A above.

alternatives are available to each if the bargaining process breaks down and the parties go their separate ways. These alternatives are known as *threat points*. No rational party will accept a worse bargain than it could get at its threat point.

A station's alternatives to affiliating with a given network include affiliating with a competing network or remaining independent and obtaining programming in the syndication market.[63] There are hundreds of independent stations in operation today.[64] And over the ten-year period from 1986 to 1995, there were 78 affiliate switches among ABC, CBS, Fox, and NBC.[65] The existence of independent stations, as well as the large number of affiliation switches in the mid-1990s, both illustrate the fact that stations have viable alternatives to affiliating with a given network.[66] On the other side of the bargaining table, a network's alternatives to affiliating with a particular television station are to affiliate with or purchase another station in that market, if any are available. In some cases, the network may be able to rely on cable distribution of its signal. For example, Fox and The WB Network both rely on cable as their sole sources of distribution in some markets.

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63 In 1994, for example, television stations aired 259 different programs supplied by syndicators, which were packaged and distributed by over 48 separate companies. First-run programming accounted for 75 percent of these shows, including over half of the 50 syndicated programs with the largest weekly gross market share. (*An Economic Analysis of the Prime Time Access Rule*, submitted by Economists Incorporated in MM Docket No. 94-123, March 7, 1995, at 17-18.)

64 See Figure 18 above.

65 Beutel, Kitt, and McLaughlin, "Broadcast Television Networks and Affiliates—1980 and Today," National Economic Research Associates (October 27, 1995) attachment to Comments of the Network Affiliated Stations Alliance, *In Re 1998 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, MM Docket 98-35 (July 21, 1998), Figure 3.

66 One of the most dramatic switches occurred in May, 1994 when the Fox network reached a deal with the group owner New World in which several affiliates switched from one of the three original networks to Fox. Within the next several months, at least 68 stations changed their affiliations in 37 markets. (Julie Zier, "Fog of war engulfs affiliation battles; affiliation of television stations with networks," *Broadcasting & Cable*, December 5, 1994 at 50.)

Bargaining is also influenced by the fact that many network affiliates are controlled by large, sophisticated group owners, such as A.H. Belo Corporation, Cox Broadcasting, Inc. and Hearst-Argyle Television, Inc. There is simply no reason to believe that these companies, many of which own large numbers of properties in various media, are going to be coerced in their relationships with the networks. In many cases, group owners have affiliation agreements with different networks for their different stations.[67] Hence, these group owners are acutely aware of what is going on in the affiliation market.

Those who argue that regulation is needed to correct for an imbalance of market power often count the number of stations in a given Nielsen Designated Market Area and compare that with the number of networks. This approach is fundamentally flawed. It is a mistake to conclude that there is a problem in television markets in which there are more stations than networks. This is so for two reasons. First, these are the markets in which there are the most local outlets (even if one does not include cable channels) and thus are the markets in which there is likely to be the strongest competition to meet local viewer needs. Thus, these are markets in which market forces will most strongly promote localism and high-quality programming generally. Second, the existence of a number of independent stations in a market proves that network affiliation is not essential to station survival. Stations in these markets have viable alternatives to affiliating with a network, and the outcomes of network-station bargaining will reflect that fact.

[67] For example, Hearst-Argyle Television describes itself as the "largest ABC affiliate group, second largest NBC group and owner of two strong CBS stations." http://www.hearstargyle.com/info/letter.html, August 29, 1999.

It is not a valid counter-argument to assert that affiliates are more profitable than comparable independents. While the data indicate that this is the case, this fact merely establishes that affiliates have strong bargaining positions and are able to appropriate many of the benefits from network affiliation for themselves, rather than having these benefits accrue to the networks. In fact, there is a rather perverse circularity at play in the argument that station owners need protection because affiliation is so valuable. The "logic" of this argument is the following:

> When stations negotiate with the networks over affiliation, the stations strike deals on terms that are very favorable to the stations. Therefore, the stations would be unhappy if they were not affiliates and they thus need protection in the bargaining process because their fear of losing affiliation would otherwise drive them to accept unfavorable terms.

By this logic, the stations would *not* need protection if the networks reached *less* favorable contracts with them so that affiliation were no more profitable than being an independent!

Even if one believed that unequal bargaining power were a problem, it is difficult to see how the national multiple ownership rule provides a solution. The argument that the national cap protects affiliates from increased network bargaining power ignores the fact that stations in different local markets do not compete with one another. A network seeks the broadest coverage that it can obtain through a combination of affiliated and owned-and-operated stations. Increased network ownership of stations in one set of local markets does not reduce the value to the network of obtaining carriage through affiliates in other local markets.

Even if additional station ownership created incremental bargaining power for the networks, it does not follow that there is a public interest in blocking network station group expansion. In order to reach the conclusion that there was a public interest in blocking group expansion, one would have to establish that the hypothesized increase in bargaining power would have adverse effects on viewers or advertisers that outweighed the efficiency gains and increased network incentives to provide high-quality programming. Evidence of ill effects, let alone effects greater than the efficiency benefits, has not been put forth.

Here, a second fundamental conclusion from the economics of bargaining is relevant: there are incentives to reach agreements that maximize the total well being of the bargaining parties. When two parties bargain, each generally wants the best possible deal for itself. Even selfish bargainers, however, have incentives to cooperate in order to maximize the total returns that are available for them to divide between themselves. Thus, in the absence of obstacles to efficient bargaining, the outcome will tend to maximize the *joint* returns of the two parties. This finding is relevant because, today, television viewers have many more sources for programming than ever before, including an increasing number of local television stations and cable channels. Thus, there are greater competitive pressures for networks to work with their affiliates to offer programming that viewers want, whether network or local. The bottom line is that broadcasters today are collectively under greater pressure than ever to air the programs that viewers desire. The networks do not have financial incentives to weaken their affiliates to the point that their abilities to serve viewer interests are harmed.

In summary, the argument that affiliates need to be protected from the networks confuses the affiliates' private interest with the public interest. The two are very different. While some network affiliates may believe that the national multiple ownership rule serves their private financial interests, there is no evidence that this is a public interest benefit. Indeed, for the reasons discussed elsewhere in this white paper, the rule harms the public interest.

The National Ownership Cap Does Not Meaningfully Promote Diversity. Perhaps the argument most forcefully asserted by the national multiple ownership rule's proponents is that the cap promotes diversity. But such a claim misses a fundamental point: viewing is local. Hence, the national coverage of a given station group has no direct effect on diversity. Moreover, because of the efficiencies of group ownership, relaxation of the rule could promote increased competition in the provision of news and public affairs programming. In fact, in 1984 the Commission concluded that there was "important evidence that allowing increased group ownership will aid in providing consumers with the variety of information they want."[68]

The Federal Communications Commission has distinguished at least three concepts of diversity: outlet, source, and viewpoint. *Viewpoint diversity* refers to attempts to ensure that media present a "wide range of diverse and antagonistic opinions and interpretations."[69] *Outlet diversity* refers to a "variety of delivery services (e.g., broadcast stations, newspapers, cable, and DBS) that select and present programming

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68 *In the Matter of Amendment of Section 73.3555 [formerly Sections 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations*, Report and Order, released August 3, 1984, ¶ 52. Footnote omitted.

69 *In the matter of 1998 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, Notice of Inquiry, MM Docket 98-35, released March 13, 1998, ¶ 6.